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TAGS: EFIN ECON PGOV FR PBIO
SUBJECT: FRANCE AND GERMANY COORDINATE COMPLAINTS ABOUT THE DOLLAR DECLINE

¶1. SUMMARY. Using the semiannual Franco-German Economic and Finance Committee meeting as a springboard, French and German Finance Ministers jointly called for coordinated G7 action on the declining U.S. Dollar; reiterated their desire for reform of the European Stability and Growth Pact; and discussed tax harmonization, international development aid, and European industrial strategy. END SUMMARY.

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New French Finance Minister Conveys Message that Franco-German Relations are Close
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¶2. In another show of Franco-Germanic agreement on economic policy, French and German Finance Ministers Herve Gaymard and Hans Eichel convened an Economic and Finance Committee meeting in Paris on January 24, along with Bank of France and Bundesbank Governors Christian Noyer and Axel Weber. At his press conference after the meeting, Gaymard emphasized his close working ties with his German counterpart. Regarding the substance, Gaymard said the parties had engaged in a very broad survey of economic, financial and budget issues. The discussions will continue when President Jacques Chirac meets German Chancellor Gerhard Schroeder on March 7. Gaymard and Eichel will meet again on March 26 in the fifth Franco-German Ministers' Council in Paris.

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Call for coordinated G7 action on the Dollar Decline
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¶3. France and Germany agreed on the need for coordinated action by the U.S., Asia and Europe to stem the decline of the U.S. Dollar. France and Germany called on the U.S. to have "precise commitments" by reining in its persistent budget and current account deficits, agreeing with the IMF that "adjustment for U.S. deficits should not be made through foreign exchange rates." Gaymard argued that "Europe has shouldered too big a portion of the burden of dealing with global economic imbalances." The criticism reflects European policy makers' concern that the strength of the euro (a 34% rise against the U.S. Dollar in the past three years) has restricted economic growth in Europe by driving up European export prices. Noyer reinforced the calls for the U.S. to address its deficits, saying "the U.S. must work towards a rebalancing between savings and the need for private investment." Nonetheless, he made clear that each country in the world has to make reforms in its own economy, stressing that Europe and Japan could do more for their growth by pursuing structural reforms, while Asia's emerging economies had to do more for the flexibility of their currencies, and also for opening their economies.

¶4. Journalists asked how France and Germany intended to pressure the U.S. government in the context of the upcoming G7 meeting. Noyer stated that the intention was "to get a global and consensual vision. The difficulty is to implement all this, which is always complicated and takes time." Eichel shared that view, but added that he did not expect "any spectacular decision to be made at the G7." "It is preferable not to cause a sudden change in structures that will be harmful to all in the current international context."

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France and Germany Support Revision of the European Stability and Growth Pact based on Economic Analysis
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¶5. Addressing the budget deficits of some countries in Europe, Gaymard stressed that "the deterioration in the eurozone's budget deficits did not reflect anything other than the impact of economic slowdown. This is a big change compared to the past, thanks to the European Stability and Growth Pact." He highlighted that "revising the pact is not an acknowledgment of failure, but the common desire to improve it." Both France and Germany agreed it would be

desirable to introduce more economic analysis into the Pact, including a more qualitative approach to budget spending. Eichel added that "the point is not to get more flexibility in the pact, it's to get a reasonable economic approach," saying that "interaction between the European Commission and the Council was necessary, with all this to be coordinated with the European Central Bank." That said, France and Germany have not put into question thresholds enshrined in the pact (budget deficits limited to 3% of GDP and debts to 60% of GDP). The GOF pledges to meet the 3% EU limit in ¶2005.

¶6. Quizzed whether there was convergence between the governments of France, Germany and Italy, Gaymard answered that French officials were to discuss French-German proposals to reform the European Stability and Growth Pact with their Italian counterparts in Rome on January 25. "Europe is rich with very tight bilateral contacts that transform later into common action at the European level. We rely on Jean-Claude Juncker's huge talent to get a text acceptable to all."

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Controlling Budget Deficit will Help France to Reduce Unemployment
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¶7. Asked about rising unemployment in France, even though economic growth is higher than in Germany, Gaymard explained that the GOF policy is targeted at restoring business and consumer confidence by mastering budget deficits through reducing both budget spending, and taxes and contributions. The second axis of the GOF policy is to take specific structural measures in favor of employment. Gaymard said that, in addition to measures taken since 2002, a Council for Jobs Orientation composed of union representatives and labor specialists will help to make progress on labor issues.

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Petroleum Tax Issue: Germany Approves French Decision
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¶8. Eichel agreed that the French decision to transfer a portion of tax on petroleum products (Taxe Interieure sur les Produits Petroliers - TIPP) receipts to French local authorities was not obliged to be strictly in line with European mechanisms discussed by the 25 European Union countries members on September 17. Nonetheless, Eichel reiterated that tax issues required some coordination, and that "Europeans' interest was to move towards more tax harmonization of direct and indirect taxes." On the income tax issue, France and Germany have an initiative to define a common basis for corporate income taxes in Europe. Hungary is willing to join the initiative.

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France and Germany Agree on International Development Aid
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¶9. Gaymard said that French and German countries shared the same philosophy on international development aid including international financial facility, debt-related issues, and President Jacques Chirac's proposals to create a new international contribution to finance development: "Europe must continue to be a force to help developing countries. For sure, this policy has to be implemented by various budget and financial instruments, and must be adapted to the needs of each developing country." Eichel concurred, recommending that debt relief be subject to measurable conditions (effectively reducing poverty, improving sanitary conditions, providing drinking water, and schooling). France and Germany agreed to continue to exchange views on international development aid and to consult with other European partners throughout 2005.

GOF for a European Industrial Strategy

¶10. Journalists raised questions about the GOF's intervention in the industrial sector (referring to injection of capital into Alstom-Sanofi), and about France and Germany's willingness to have European industrial champions. On the first issue, Gaymard answered "it is legitimate that a finance minister has concerns about his country's industrial sector in an open and global economy - this is not limited to France, but to all of the EU economic space." "The GOF," he continued, "is not returning companies to the public sector; in fact, French finance ministers have continued privatizing companies or opening capital of state-owned companies." On the second issue, Gaymard reminded the audience about Jean-Louis Beffa's report for a new industrial policy that proposed the creation of an agency for new industrial strategies. (The Agency for Industrial Innovation with Beffa as a head should

be created in June 2005). Beffa, who is Chairman of Saint-Gobain, is also co-chairing a Franco-German group of industrialists that defines concrete projects. Gaymard did not get into details, but stated that "Europe must remain a big agricultural and industrial force; it has no vocation to be only a museum with services jobs, as respectable and great as they may be."

Comment

¶11. The event helped to fortify the political message that France and Germany still are closely allied on economic policy, a significant achievement in and of itself. However, the Finance Ministers' concerns about the US deficits (and its arguable contribution to the appreciation of the euro) do not translate into any concrete new proposals about how to address either country's own economic problems. Higher economic growth may help France to reduce unemployment (still at 9.9%) and its budget deficit, but the GOF still needs to lower the tax burden, eliminate labor market rigidities, and scale back the role of the state in the economy.
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